BEFORE APPRAISER JAMES A. GREENLEAF, MAI

In the matter of the Appraisal of the

DESIMONE\DUWAMISH MARINA PREMISES LEASE

LESSEES' ARBITRATION MEMORANDUM

INTRODUCTION

The parties entered into the Lease in 1974 and extended the term and reworked the Lease in 1977.[1] The underlying principal was that the Lessees' ***were taking all of the development risk*** and for that reason would receive the benefits of the proposed development. The Landlord agreed that it would receive a return only on the value of the raw and unimproved land over the lease term—consistant with the fact that the Landlord was making no investment and was taking no risk in the development. In addition, the Landlord would obtain ownership of the improvements at the end of the lease term. Lessees improved the property for container storage and built a marina that could not be built today. Landlord has received a return on its land over the term of the lease and will obtain valuable and unique improvements at lease termination.

In this arbitration, Landlord is over-reaching and seeks a valuation as of June, 2002, far in excess of the fair market value of the undeveloped land. Landord's valuation, if

[1] The Lease was restated in 1977 and that is the version before the arbitrator. See Lease at p. 31, ¶ 26 for further explanation.

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accepted, would deprive Lessees of the benefit of the investment in the development and would frustrate the original agreement of the parties.

Lessee's overall valuation of $800,000 is inherently more reasonable and reliable than the valuation asserted by Landlord. Lessee's appraiser has utilized three valuation methods to arrive at an overall estimate of value of $800,000. The Landlord's appraiser has used only a single valuation method—and a method which in this case is fraught with risk of overstating value. Indeed, that is exactly what has occurred. Landlord's appraisal contains substantial errors including an overstatement of the usable area and understatment of the costs necessary to bring the site to a ready to build condition. The result is that the Landlord now claims a grossly inflated and unreasonable value for the site.

This memorandum will address the differences in the appraisals submitted by the parties and demonstrate that the Landlord's appraisal presents an overstated and unreliable estimate of value. Lessee respectfully requests that the Arbitrator reject the Landlord's erroneous estimate and adopt the valuation submitted by Lessees.

ANALYSIS

A. The Landlord's Appraisal Ignores the Most Compelling Evidence of the Value of the Site.

The original Lease was the result of arms length negotiation. Because the Lease sets forth the rate of return, it is useful to consider the initial Lease rate as a method to back out the fair market value of the property in 1974. That valuation can then be escalated to provide an estimate of value as of 2002. Landlord's appraiser chose not to engage in this analysis.

However, Lessee's appraiser did this analysis and found an imputed 1974 value for the undeveloped site of $180,000 based on the rental formula in the Lease. Using several alternate methods to escalate this value to June of 2002, this approach indicated a value of $750,000. (Gibbons appraisal p. 77-81).

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This valuation method is compelling because it starts with an arms-length transaction in 1974 between parties knowledgable about the site. Lessee's overall estimate of the value as of June 2002 ($800,000) suggests that the raw land would have appreciated more than 400% (i.e., from $180,000 to $800,000) in the period 1974-2002. This estimate of appreciation is consistant with value patterns in the Duwamish neighborhood. This valuation is also attractive because it ***yields a result consistant with the other two valuation methods*** utilized by Lessee's appraiser.

A common sense check of the Landlord's estimate of value against the 1974 value is not similarly comforting. From a 1974 value of $180,000, the Landlord suggests that the value of the identical parcel as of June, 2002 would be in excess of $4 million, appreciation of more than 2,200%. The exhorbitant appreciation claimed by Landlord is even more disconcerting because the Landlord admits that as of 2002 it was not economically feasable to dredge and develop a water-dependant use. (See Shorett appraisal p. 25 "We believe the current marina market is not strong enough to support the cost to develop a marina similar to that constructed on the site and thus is not an economically viable use. ") In otherwords, juxaposed against the landlord's claim of 2,200% appreciation is the admission that the property is less useable today than it was in 1974.

Lessee respectfully submits that of the alternative methods available to value the property in its 1974 condition, a method which starts out with a 1974 baseline value which can then be escalated has much to recommend it. This is particularly true where, as here, the 1974 value is derived directly from a simple formula contained in the Lease. Lessee's request that in considering this matter, the Arbitrator give substantial weight to the "Historical Land Sales Approach" set forth at p. 75-81 of Lessee's appraisal.

B. <u>The Landlord's Appraisal Also Ignores the Raw Land Sales Approach.</u>

It is also interesting to note that the Landlord's appraisal makes no effort to value the site as if in its raw 1974 condition by using raw land comparables. The most direct approach

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to value the site is to consider comparable sites as of June of 2002 which are in or can be adjusted to approximate the subject in the 1974 condition.

Again, only the Lessee's appraiser performed this analysis. (Gibbons appraisal p. 69-74). This approach yielded a valuation of $850,000 which, again, was in the range of the other two approaches considered by the Lessee's appraiser and therefore provides confirmation of the overall estimate of value. Lessee requests that the Arbitrator give substantial weight to this approach as well because of its relative simplicity and because this approach also provides confirmation of Lessee's overall estimate of value.

C. The Landlord's Reliance on Only One Approach Combined with Errors in That Approach Result in Landord's Presentation of a Grossly Unreasonable Estimate of Value.

Both appraisers have attempted a development approach in an effort to value the property. However, this approach should be used with caution because of the substantial risk of overvaluing the site by failing to take into account all of the site work deductions which would be necessary to bring the site into a ready to build condition. Indeed, it is exactly the failure of the Landlord's appraisal to accurately assess site development costs (along with an overstatement of the usable area) which lead to Landlord's unreasonably high estimate of value. The failure of the Landlord to accurately address the usable area and the failure to accurately set forth the site penalty are addressed below.

1. The Landlord's Appraiser Erred by Applying 1974 Land Use and Environmental Regulations.

The Lease does not state anywhere that the property is to be appraised subject to 1974 land use and environmental regulations. Nonetheless, Landlord's appraiser claims that " It is our opinion that the zoning applicable in 1974 is inclusive of all regulatory controls that existed at that time including environmental regulations." (Shorett Appraisal, p. 3-4) Landlord's appraiser then apparently concludes that under the 1974 regulations there would

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have been no reduction of usable area and that 100% of the uplands would be usable. Id. at 21.

Applying 1974 land use and environmental regulations is contrary to the instructions in the Lease and leads to an overstatement of the usable area. The plain meaning of the Lease and the intent of the Lease instructions demonstrate that the Property should be appraised subject to current regulations.

a. The Plain Language of the Lease Does Not Support Applying 1974 Land Use Regulations.

In construing a Lease, the arbitrator should consider the plain meaning of what is written. Here, the provision of the Lease relied upon by the Landlord's appraiser reads as follows:

> Said appraisers shall appraise said property at its highest and best use within the zoning applicable on October 11, 1974....(Lease at ¶3(b) p. 6)

The reference in the Lease to "zoning" is limited to the context of determining the "highest and best use" of the Property. Once the "highest and best use" is determined, the Lease does not provide for any further consideration of the 1974 zoning. Since the MH zoning of the property is substantially the same now as it was in 1974, the issue of the zoning classification of the property is moot.

The parties went to great lengths in the Lease to define the appraisal methodology. The Lease reflects that the parties were well aware of the significant land use and environmental regulations in place in 1974. See Lease at ¶7 (Use of Premises) Moreover, the Lease reflects that the parties understood the difference between "zoning" and other federal, state, or municipal "laws, rule, order, ordinance and regulation." Id. Indeed, ¶ 7 of the Lease differientiates between compliance with the "zoning classification" of the Property and compliance with state, federal and municipal "regulations." Id.

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If the parties had intended to lock in more than the zoning classification in 1974, and intended to also include the myriad other state, federal and municipal regulations they could have easily said so. However, no such words exist in the Lease and the Arbitrator should decline the invitation to rewrite the language of the Lease to add those words.

b. The Landlord's Proposed Interpretion of the Lease Is Contrary to the Intent of the Parties.

If the parties had wanted to lock in the existing factors affecting value, the parties would have simply fixed the rent and then provide for escalation by the cost of living—or some other index. Instead, here the parties rejected that approach and entered into a "revaluation ground lease."[2] Plainly, the intent was not to lock in the original value but rather to periodically find the fair market value of the original unimproved land.

Implicit in periodic "revaluation" is that all relevant factors will be considered. Therefore, ***the presumption*** should be that unless explicitly limited, all market factors will be considered at the time of revaluation.

Here, the parties did no more than lock in the zoning classification at the Landlord's request to protect against a downzone. However, contrary to locking in 1974 land use and environmental regulations, the Lease expressly states that the existing permits have expired: "Lessees are aware that a King County Grading Permit for the Premises has expired, that a new permit must be obtained,...Lessees agree to obtain such permit and any other permits which may be lawfully required by any governmental agency..." Lease ¶7, p. 10. Moreover, the Lease expressly placed future compliance with whatever regulations might exist the Lessee's responsibility:

> The Lessees,....may at any time construct....improvements,... provided such improvements are constructed in accordance with all

[2] Landlord's counsel so characterized the lease in a letter to the Arbitrator of May 8, 2003 ("The form of lease is a revaluation ground lease.'")

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applicable regulations and requirements of any governmental authority having jurisdiction thereof. (Lease ¶ 8)

In short, both the plain meaning of the words in the Lease and the parites intent to periodically revalue the raw land dictate that the valuation as of 2002 include consideration of the impact of 2002 land use and environmental regulations. These issues are addressed in detail in the letter of Melody McCutcheon included with Lessee's appraisal and that analysis is incorporated by reference and not restated here.

2. The Landlord's Appraisal is Also in Error Regarding Submerged Area.

Landlord's appraiser states that in 1974, the total submerged area was 64,553 square feet. (Shorett Appraisal p. 21). This calculation is based on a handwritten note that someone apparently employed by David Evans and Associates wrote on a copy of a 1981 survey. (See Shorett appraisal at Addendum I). The Landlord's calculation of the submerged portion of the site is simply wrong. At the hearing, Lessee will verify that the actual submerged area is approximately as set forth in the appraisal.

In summary, the total usable square footage is as follows:

Total parcel size	500,952 sq. ft.
Less submerged land	(83,195) sq. ft.
Less wetlands and buffers required under 2002 regulations	(76,867) sq. ft.
Total usable land	340,890 sq. ft.

3. The Landlord's Appraiser Erroneously Assigned Value to the Submerged Portion of the Site.

Landlord's appraiser values the submerged parcel at $3.47 per foot based on the "utility" of the submerged land. (Shorett Appraisal p. 32). In fact, there is no such "utility." Land use attorney Melody McCutcheon states:

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> The Duwamish Waterway is a designated Superfund site under CRECLA due to contaminated sediments, and there are very shallow water depths adjacent to the property. Given the contaminated nature of the Waterway, the need for substantial dredging in order for the property to be accessed from the Waterway, and the costs and practical difficulties of conducting such dredging operations, it is reasonable to presume that future development would only be of the upland area, and not the submerged area.

Because of the environmental and regulatory issues and the probable uses of the Property as of 2002, it is respectfully submitted that no willing and reasonably informed buyer would pay anything for the submerged part of the site.

4. The Landlord's Appraisal Substantially Understates the Site Penalty the Market Would Impose on the Usable Portion of the Site.

Because the appraisers used different catigories to define site penalty costs, it is difficult to corralate the appraisals regarding costs. However, Lessee has attempted to do so and offers the following:

Comparison Analysis
Gibbons vs Shorett

Item	Description	$/sf usable	Shorett $/sf usable	Comment
Area Assumption		340,890sf	436,309sf	Shorett includes shoreline setback, creek setback and creek itself in area estimate.
HARD COSTS				
Site Development				
1	Remove cement tailings	$0.66/sf	zero	Shorett assumes his site clearing and grading cost of $0.06/sf (included in item 3) covers this item.
	Environmental Allowance	$0.29/sf	zero	Shorett has no allowance for any environmental issues, testing or consultation.
2	Excavation of unsuitable soils	$0.09/sf	zero	Shorett has no allowance under his assumptions that soils are suitable for development.
3	Preload and fill	$2.73/sf	$0.42/sf	Shorett assumes no preload and fill requirement - basically just "clearing, excavation & site prep"
	Additional structural fill allwc.	$0.19/sf	zero	Shorett has no allowance under his assumptions that soils are suitable for development.

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4 Import & place 6" crushed rock	$0.10/sf	zero	Gibbons cost reflects the fact that comparable properties sold have compacted gravel at sale.
5 Shoreline stabilization	$0.48/sf	$0.37/sf	Shorett's allowance is based on a manual, Gibbons on actual bid estimate from Santana.
6 Creek stabilization	$0.59/sf	zero	Shorett has no allowance, despite assuming creek area to be usable.
7 On-site utilities loop	$0.23/sf	zero	Shorett has no allowance. Owners were required to provide a loop when they brought water on to the site.
8 Utilities creek crossing	$0.18/sf	zero	For crossing creek to provide utilities to northern property. Shorett has no allowance as treats property as one parcel.
9 Trenching cost	$0.16/sf	zero	This is the cost for trenching for installation of utilities. Shorett may be including in his utilities figures.
Other costs			
10 Dewatering allowance	$0.04/sf	zero	This is necessary for water containment during site work.
11 Erosion control	$0.20/sf	zero	This is necessary to protect erosion of sediment and washing of sediments into the Duwamish, drains etc
12 Hydroseeding	$0.03/sf	zero	Necessary for areas of trenching, and site work.
13 Traffic Control	$0.08/sf	zero	Necessary for movement of materials on and off the site.
14 Street cleaning	$0.11/sf	zero	Necessary to clean city streets after movement of material on and off the site.
Subtotal Site Development Costs	**$6.16/sf**	**$0.79/sf**	
Infrastructure			
15 Offsite Sewer & Storm sewer	$0.39/sf	$0.36/lf	Shorett figure is based on trended historical cost - Gibbons figure uses current contractor allowance.
17 TV sewer line	$0.00/sf	zero	Required post installation to look for cracks etc - Shorett has no allowance
18 Frontage roads	$0.21/sf	zero	Shorett assumes the county would pay for this cost. No explanation as to why they would do this.
Subtotal Infrastructure	**$0.61/sf**	**$0.36/sf**	
Subtotal Hard Costs	**$6.77/sf**	**$1.15/sf**	
Hard Cost Add-ons			
Bonds & Insurance	$0.10/sf	zero	Shorett has no allowance. Gibbons uses Santana charge of 1.5% of costs.
Contractor Overhead & Profit	$1.02/sf	zero	Shorett has no allowance. Gibbons uses Santana charge of 15% of costs for contractor profit and project management.
Sales Tax	$0.60/sf	zero	Shorett has no estimate - presume this is included in costs above. Gibbons is based on Santana Trucking.
Contingency	$0.68/sf	zero	Shorett has no allowance. Gibbons uses Santana charge of 10%.
Total All Hard Costs	**$9.16/sf**	**$1.15/sf**	

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SOFT COSTS			
Soft Costs			
Engineering, professional fees	$0.08/sf	$0.13/sf	Shorett uses 10% of costs. Gibbons bases estimate on Group 4 quote.
Permits, EIS	$0.15/sf	$0.15/sf	Shorett uses historical trended cost. Gibbons bases estimate of land use attorney quote.
Subtotal Soft Costs	$0.23/sf	$0.28/sf	
TOTAL HARD & SOFT COSTS			
All Hard & Soft Costs	$9.39/sf	$1.43/sf	
LAND VALUE ESTIMATE			
Finished Land Value	$11.50/sf	$11.00/sf	Shorett estimate is at $10.50, but includes additional value for submerged land, = $11/sf over his usable land area.
Less			
Site Penalty	-$9.39/sf	-$1.43/sf	Line from above
Developer's Gross Margin	-$1.15/sf	-$0.33/sf	Shorett estimate is based on 25% of costs and includes overhead & admin. Gibbons is 10% of total investment.
As Is Where Is Land Value	$0.96	$9.24	
Rounded	$0.97/sf	$9.24/sf	

At the hearing, Lessee will demonstrate that its calculation of the costs to bring the site to a buildable condition are accurate. In particular, Lessee will demonstrate the soils conditions are such that substantial quantities of fill are required and that the estimates presented are conservative.

CONCLUSION

The three valuation methods of Lessee's appraiser, when taken together provide a reasonable and fair estimate of value. Lessee's approach is particularly compelling in this appraisal because Lessee relies in part on a value as of 1974 established by the parties themselves. Landlord's appraisal substantially overstates the value of the property and should be rejected.

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Dated this 16th day of July, 2003.

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By _____
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DFT 000071

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CERTIFICATE OF SERVICE

The undersigned certifies that on the 16th day of July, 2003, I caused Lessees' Arbitration Memorandum to be served via email and facsimile on the following parties:

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I declare under penalty of perjury under the laws of the State of Washington that the above testimony is true and correct.

EXECUTED this 16th day of July, 2003.

Jeffrey G. Maxwell

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